WEEKLY

Economic Commentary

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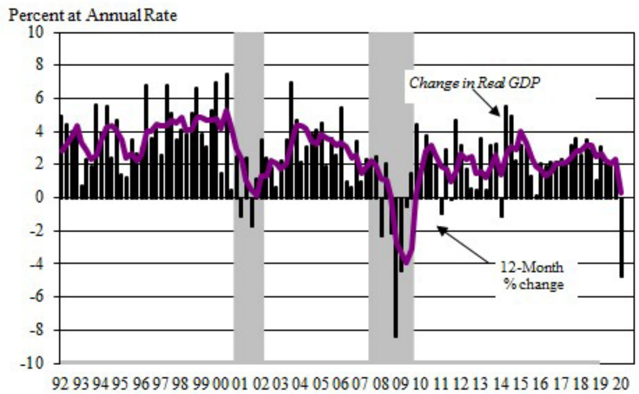
Millennium
CORPORATE CREDIT UNION

Since the end of the Great Recession, the Federal Reserve has consistently overestimated the strength of the U.S. economy, delivering forecasts of growth and inflation that almost always exceeded actual results. That string of optimistic forecasts has come to a crashing end, done in by a pandemic that has profoundly chastened the central bank. Forget any language that might hint at a V-shaped recovery. In the policy statement following the FOMC meeting this week, the Fed's concern over future prospects for the economy couldn't be more dire. "The ongoing public health crisis will weigh heavily on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term. In light of these developments, the Committee decided to maintain the target range for the federal funds rate at 0 to 1/4 percent. The Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."

When that confidence returns is anyone's guess, but none of the hawkish officials on the policy-setting committee raised any objections to the "whatever it takes" approach to get the economy back on the right track. The magnitude of that task was driven home by the latest batch of economic data, which, as bad as they were, only hints at the awful performance the economy will endure during the second quarter. Indeed, it almost seems quaint to describe the 2007-2009 downturn as the "Great" Recession since the contraction in economic activity now underway will be far deeper. True, the 8.4 percent decline in GDP in the third quarter of 2008 still stands out as the worst quarterly setback in sixty years, well in excess of the 4.8 percent decline reported for the first quarter this week.

But the latest GDP report only captures a sliver of the depressed activity that is currently unfolding, as lockdown restrictions, social-distancing mandates and massive layoffs didn't take full effect until the final month of the period. Still, the report provides insight into how pervasive the downturn is shaping up to be. Led by a 7.6 percent collapse in consumer spending - the sharpest since 1980 - the coronavirus exacted a toll on all sectors of the economy, although residential activity, which benefited from a strong start to the year, posted a modest gain for the quarter. But like the rest of the economy, housing and construction activity has since retreated and will contribute to the precipitous downturn in GDP during the current quarter.

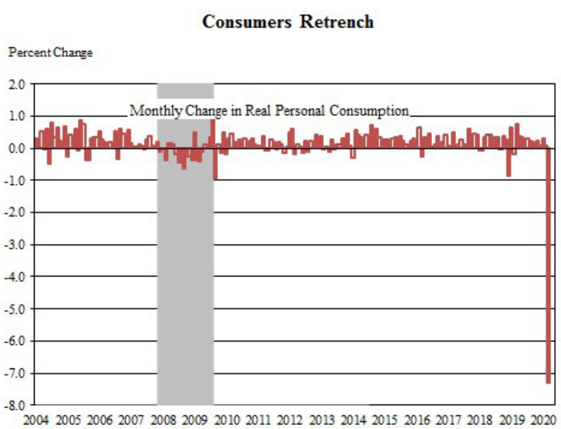
R.I.P. The Longest Expansion



We expect that the slide in economic activity will make the trough of the Great Recession seem like a minor disruption, with GDP plunging by an annual rate of about 40 percent in the current quarter. The blow to employment will be just as overwhelming. During the last recession, the economy shed 8.7 million jobs, driving the unemployment rate to a peak of 10 percent. Over the past six weeks alone more than 30 million workers have been laid off, including 3.8 million in the latest week. What's more, a sizeable number of laid off workers did not qualify for unemployment benefits and, hence, will not be captured in the unemployment rate that will be released next week. Even so, the official jobless rate will tower over the 20 percent peak reached in the last recession, climbing to close to 20 percent.

To be sure, the Great Recession was "Great" not only for the severity of the contraction but also for its length. The eighteen months between the peak and trough were the longest in the post-World War II period as was the length of time it took for the job-creating engine to crank up again. The recovery this time should be considerably shorter, assuming the nation is able to successfully flatten the infection curve this summer and contain a possible second wave of outbreaks later in the year. Even before health officials are able to declare mission accomplished the economy is starting to reopen, with several states relaxing lockdown restrictions and more planning to follow over the coming months.

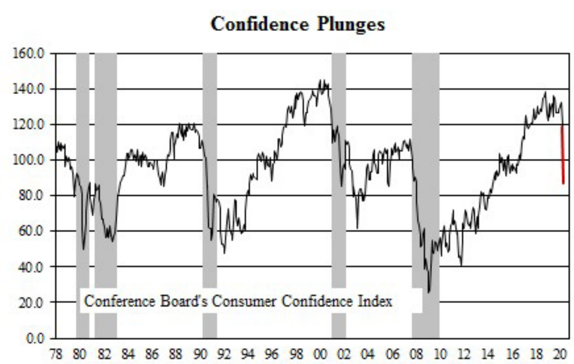
The problem is, polls show that the vast majority of the population believes it is too early to relax restrictions, suggesting that businesses able to reopen their doors may not see much in the way of returning customers. Clearly, consumers are staying away in droves. As noted earlier, the first quarter's GDP setback was heavily skewed towards the end of the period, when lockdowns become pervasive and fears associated with Covid-19 reached a feverish pitch. As the tidal wave of layoffs washed ashore towards the end of March, the response by consumers was just as abrupt. Personal spending plunged by 7.5 percent during the month, the sharpest decline on record, and by 7.3 percent after adjusting for inflation, which was also a record. With personal consumption accounting for 70 percent of GDP, the consumer retrenchment was, not surprisingly, the biggest weight dragging the broader economy down during the period.



Importantly, the consumer drag will be considerably larger this quarter. But the timing should be the mirror image of the first quarter. The bulk of the damage should be seen early in the period when lockdown restrictions are the most stringent and job losses the greatest. As spring turns to summer, several tailwinds should put a floor under spending and set the stage for a gradual recovery. The first ray of light will come from the lifting of restrictions, allowing more businesses to reopen and households the ability to satisfy pent-up demand generated during the lockdown. Second, households will be fortified with the massive stimulus checks sent out under the CARES Act, including the expanded unemployment benefits and $1200 direct payments to households with annual earning of less than $75000.

It remains to be seen how aggressively households revive their shopping habits. No doubt, it will take time before they feel confident enough to fully reopen their wallets and purses. The shock from the astonishing sudden spike in layoffs sent tremors through households, resulting in a drastic reordering of balance sheet priorities. The pullback in spending in March far exceeded the decline in incomes, as households opted to build up their precautionary savings. The personal savings rate leaped from 8.2 percent to 13.5 percent, the highest level since 1975. That savings surge reflected the dismal state of mind that gripped households as pandemic fears escalated and income prospects shriveled.

Indeed, the negative mindset of households deepened considerably in April. The Conference Board's Consumer Confidence Index suffered its sharpest monthly decline on record, falling by a stunning 31.8 points. That was double the hefty 13.8 point drop in March and is another sign that the consumer spending retrenchment seen that month was even larger in



April. Not surprisingly, the slump in household spirits paralleled the erosion in the job market. The share of consumers saying that jobs were hard to get jumped to over 43 percent from 20 percent, and the share expecting incomes to decline surged by 80 percent, from 10.1 percent to 18.5 percent. That grim assessment strongly suggests households remained in hibernation last month, husbanding their resources at the expense of spending.

But the Conference Board's survey also provided a glimmer of hope that consumers will soon come out of their shells, albeit very cautiously. The record-setting decline in confidence last month was paced by deteriorating perceptions of present conditions. That's understandable given the upsurge in layoffs and cutbacks in weekly earnings during the month, as employers curtailed worker hours and in many cases wages. But amid the dispiriting collapse in present conditions felt by households, their expectations of future conditions actually improved a tad. Consumers expect both overall business conditions and job prospects to perk up in coming months.

To be sure, confidence measures are not reliable predictors of spending trends. But the uptick in expectations is an encouraging sign that households view the carnage from the pandemic as more of a temporary blow to the economy rather than a sustained shift in fundamental economic prospects. Even so, the health scare has been so pronounced that normal behavior is not likely to return anytime soon. It is hard to believe that consumers would resume traditional shopping habits, flocking to crowded malls, entertainment venues or travel as willingly as they had in the past. That will only come when fears of the pandemic fully recede, something that is not in the cards until health professionals develop a vaccine or treatment of the disease.

Hence, the revival in consumer spending and in overall economic activity will proceed gradually and contend with lingering risks that a second wave of infections later this year would short-circuit the process. The good news is that a recovery should start much sooner than was the case during the Great Recession. As big of an immediate toll Covid-19 is exacting on the economy, it is not causing as much structural damage as the financial crisis and housing collapse did during the long 2007-2009 downturn. What's more, fiscal and monetary policymakers are acting much more swiftly and aggressively to contain the carnage than was the case a decade ago. Simply put, the immediate shock is more painful than it was then, but relief should come sooner.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	May 1	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.11%	0.12%	0.01%	2.44%
6-month Treasury bill	0.13	0.14	0.16	2.46
3-month LIBOR	0.56	0.99	1.37	2.57
2-year Treasury note	0.20	0.22	0.22	2.34
5-year Treasury note	0.35	0.37	0.39	2.34
10-year Treasury note	0.62	0.60	0.60	2.53
30-year Treasury bond	1.25	1.18	1.22	2.92
30-year fixed mortgage rate	3.23	3.33	3.33	4.14
15-year fixed mortgage rate	2.77	2.86	2.82	3.60
5/1-year adjustable rate	3.14	3.28	3.40	3.68
STOCK MARKET				
Dow Jones Industrial Average	23723.69	23775.27	21052.53	26504.95
S&P 500	2830.71	2836.74	2488.65	2945.64
NASDAQ	8604.95	8634.52	7373.08	8164.00
Commodities				
Gold ($ per troy ounce)	1710.20	1741.64	1640.70	1280.20
Oil ($ per barrel) - Crude Futures (WTI)	19.69	17.11	28.83	61.90

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Real GDP (Q1) - % change Saar	-4.8	2.1	2.1	1.0
Personal Income (March) - % change	-2.0	0.6	0.5	0.0
Personal Consumption Exp. (March) - % change	-7.5	0.2	0.4	-1.0
Personal Savings Rate (March) - Percent	13.1	8.0	7.7	8.6
Consumer Confidence Index (April)	86.9	118.8	132.6	120.6

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